Wardair International Ltd.

Annual Report 1978

Wardair International Ltd.

Board of Directors

Maxwell W. Ward,	Chairman and President, Wardair International Ltd.
M. D. Ward,	Secretary-Treasurer, Wardair International Ltd.
T. L. Spalding,	Executive Vice-President, Wardair International Ltd.
W. T. Brown*,	Chairman, Odlum Brown and T. B. Read Ltd.
J. N. Hyland*,	Consultant
G. D. Curley*,	Vice-President, Marketing, Wardair International Ltd.

*members of audit committee

Officers and Senior Management

Maxwell W. Ward,	Chairman and President
T. L. Spalding,	Executive Vice-President
M. D. Ward,	Secretary-Treasurer
G. D. Curley,	Vice-President, Marketing
N. A. Patterson,	Vice-President, Finance
F. S. Dornan,	Staff Vice-President
T. B. Dunnigan,	Assistant Treasurer, Planning
N. J. Parsons,	Assistant Treasurer, Operations
D. R. Rouse,	Executive Assistant to the President
B. R. Corbett,	Director, Organization Development
E. Lysyk,	Director, Corporate Security
J. L. Shaffer,	Director, Customer Relations and Consumer Affairs
I. C. Wilkie,	Director, Legal Services

Corporate Information

Head Office:	2201 Toronto Dominion Tower, Edmonton Centre, Edmonton, Alberta, T5J 0K4
Shares Listed:	Toronto Stock Exchange Vancouver Stock Exchange
Auditors:	Thorne Riddell & Co. Edmonton, Alberta
Trustee:	Montreal Trust Company
Registrar and Transfer Agent:	Montreal Trust Company Edmonton, Toronto and Vancouver
Principal Bankers:	Canadian Imperial Bank of Commerce Toronto-Dominion Bank

Contents

Annual Meeting

The Annual Meeting of Shareholders will be held at 11:00 a.m. (M.D.T.) on May 25, 1979 at the head office of Wardair International Ltd., 2201 Toronto Dominion Tower, Edmonton Centre, Edmonton, Alberta. T5J 0K4

Financial Highlights

	1978	1977
Revenues	$143,059,000	$110,665,000
Operating costs, before depreciation and amortization	128,334,000	97,087,000
Depreciation and amortization	9,293,000	5,820,000
Earnings from operations	5,432,000	7,758,000
Interest on long term debt	11,456,000	3,924,000
Gain on sale of aircraft and related equipment	11,433,000	—
Net earnings for year	5,409,000	3,834,000
Operating margin	3.8%	7.0%
Return on average capital employed	9.5%	12.8%
Earnings per common share	$1.45	$1.08
Dividends per common share	$ .06	$ .06

To our shareholders and employees

Max Ward with maintenance staff in Toronto.

The year 1978, Wardair's 25th year of operation, was an eventful one that included both accomplishments and disappointments.

Consolidated 1978 earnings at $5,409,000 or $1.45 per common share after preferred share dividends, were at record levels. While this compares favourably to 1977 earnings of $3,834,000 or $1.08 per common share, it should be pointed out that reflected in the 1978 earnings is a one-time gain of $11,433,000 from the sale of four aircraft and related equipment. These assets became surplus to future requirements as a result of the Company's recent fleet expansion program.

Aided by the addition of three wide-bodied aircraft to the international fleet and one Dash 7 to the northern fleet, revenues reached a record level of $143,059,000 compared to $110,665,000 a year earlier, a 29% increase.

However, operations for 1978 were disrupted by delays in deliveries of aircraft because of strikes at manufacturers' production facilities, resulting in lost revenue opportunities and passenger inconvenience.

Operating costs in 1978 were $137,627,000, 33% greater than the $102,907,000 recorded in 1977. Interest costs were $11,456,000 as compared to $3,924,000 a year earlier. While much of the increase in costs was directly attributable to the fleet expansion, the drastic decline in the value of the Canadian dollar and the substantial increase in interest rates, also severely affected operating and debt costs.

With the delivery of one B-747-200 in April, 1979 and one Dash 7 in June, the current fleet expansion program will be complete and the Company will have reached another plateau in its development.

In 1979, the continuation of cost pressures felt in 1978, combined with current fuel price increases and shortages, will place a heavy burden on the Company. At the same time increasing competitive pressures and the inequities of the regulations governing charter air carriers will become more evident.

However, dealing successfully with such challenges is not new to Wardair with its history of sustained and rapid growth. We feel confident that our management organization and dedicated staff, which have been responsible for Wardair's success in the past, will ensure continued success in the years ahead.

Another real and vital key to Wardair's continued growth and success is more enlightened regulation of the Canadian airline industry and recognition of the rightful role of the charter air carrier in the fabric of the nation's air transportation system. During 1979, we look forward to a more flexible operating authority and an improved regulatory environment in keeping with the Minister of Transport's International Air Charter Policy of September 5, 1978.

However, we do not believe Canadian Federal Government air transport policy will necessarily follow the U.S. Government policy of 'deregulation' of air transport. What we do foresee is a gradual relaxation of regulatory restraints by government policy, which will allow us to compete in a more effective way with scheduled carriers' charter-type operations. Wardair's expansion program has been designed to take advantage of these anticipated changes in policy.

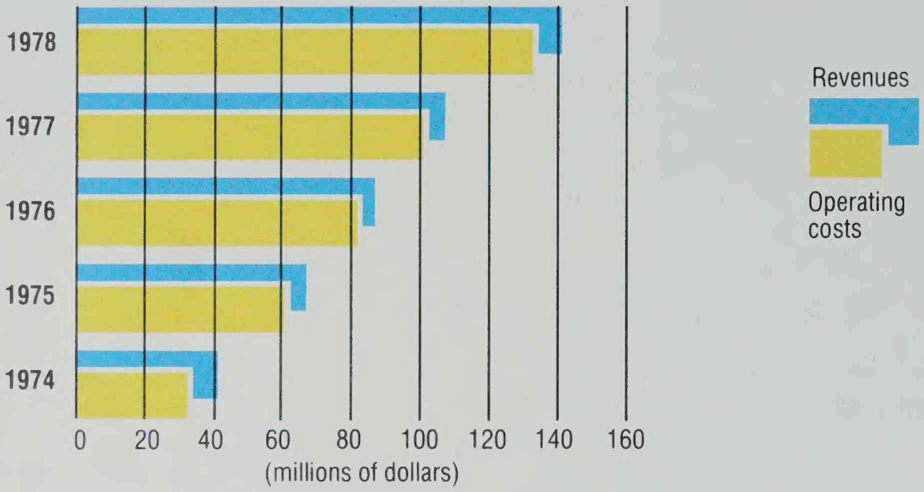
While management recognizes the next few years will be difficult, we look to the future with confidence. Given a fair opportunity to offer our service to the total air travel market, our determination to continue to live up to our reputation for high standards of reliability and service should serve us well in the years ahead. On the whole, we are in good shape to take advantage of the ever-growing Canadian transportation market.

On Behalf of the Board

Maxwell W. Ward
Chairman and President
April 27, 1979

Review of Operations

REVENUES AND OPERATING COSTS



Wardair Canada (1975) Ltd.

The fleet expansion announced in the 1976 Annual Report became a reality in 1978. Wardair added to its international fleet three of the four new aircraft ordered in 1976. One Boeing 747-200 arrived in June, and two McDonnell Douglas DC-10-30 aircraft followed in November and December.

After the sale of two Boeing 707-320C aircraft, Wardair became one of the first airlines in the world to offer all wide-bodied service in the international market. Completion of the expansion is scheduled for April 25, 1979 with the delivery of the last aircraft, a Boeing 747-200.

The international fleet will then consist of six wide-bodied aircraft – four Boeing 747s and two McDonnell Douglas DC-10s. Total capacity will be 2,422 seats.

In 1978, heavy maintenance operations located in Toronto and Edmonton were centralized in Toronto in the interests of greater efficiency and reduced costs.

Government Regulations

The long-anticipated changes in charter regulations were implemented too late to be of any value during 1978 and even then fell far short of expectations. As a result, Canada's regulatory environment is far more restrictive than that found in the U.S. or in most parts of Europe.

One of the consequences of this backward attitude by the Canadian Transport Commission is that a substantial number of travellers departing from, or travelling to Canada select routes via the United States. This loss is directly felt by the charter airlines serving Canada.

Changes to the Air Carrier Regulations in 1978 now permit charter carriers to:

1. Let passengers select the return flight of their choice;
2. Set reduced fare levels for children;
3. Allow both Canadian and foreign passengers to travel on the same aircraft.

Changes needed to provide a greater degree of equality between scheduled and charter airlines include the following:

1. Give passengers the freedom to travel to one city and return home from another;
2. Let charter airlines make enroute stops to pick-up or drop-off passengers;
3. Permit passengers with ITC (Inclusive Tour Charter) packages to travel with ABC (Advance Booking Charter) passengers;
4. Allow charter airlines the freedom to sell a limited number of seats within the pre-booking period to replace passengers who have cancelled;
5. Allow charter airlines to carry passengers and freight on the same aircraft.

It is expected that some, if not all, of the above changes will be made during 1979.

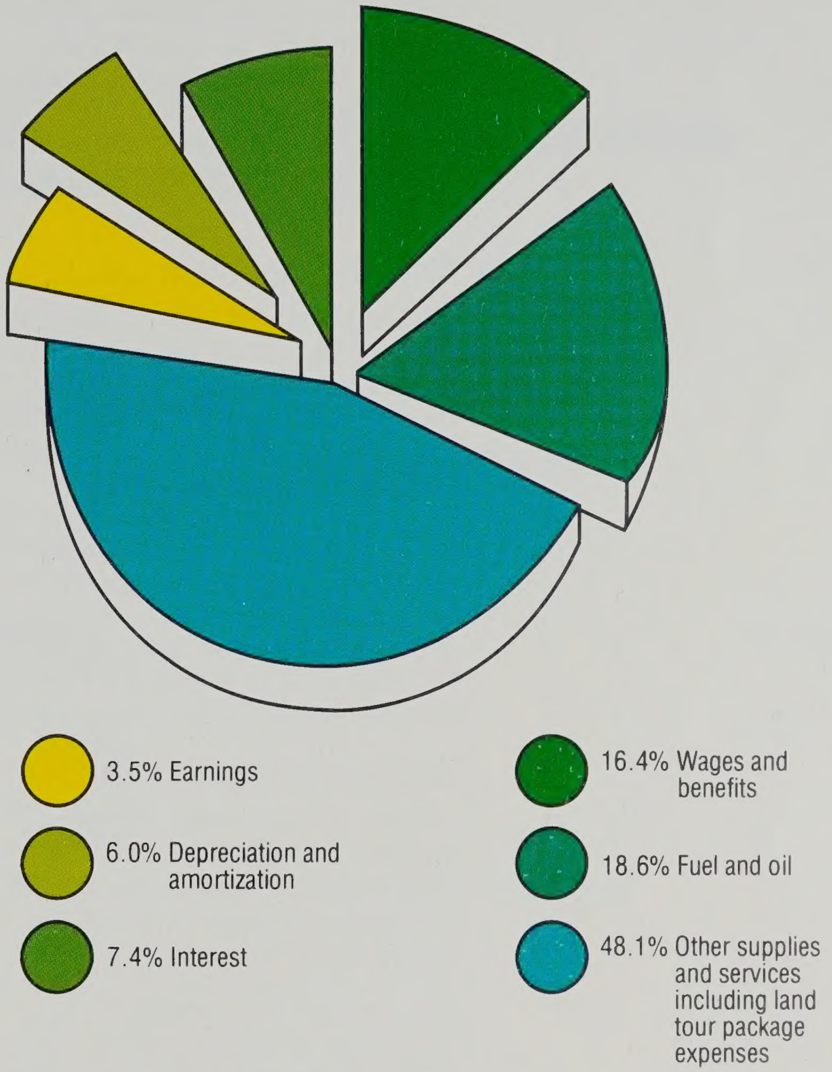
Northern Division

Development in Northern Canada, and particularly in the Yellowknife, Northwest Territories area, was generally slow during 1978. This was because of the relocation of the planned pipeline construction program. There was also a decrease in gas and mineral exploration in the area. Consequently, the entire northern airline industry experienced a reduction in demand for air service.

In spite of this slowdown, Wardair's Northern Division continued to be profitable in 1978. The Company remains confident that activity in the north will regain momentum in the near future.

In anticipation of renewed activity, the Northern Division made some changes to its fleet in 1978. The first of two de Havilland Dash 7 STOL (Short Take Off and Landing) aircraft entered service in June 1978. Two smaller aircraft, a de Havilland Twin Otter and a Mitsubishi MU 2 were sold, leaving five Twin Otters, one Grumman Gulfstream I and one Dash 7. The second Dash 7 is expected in June 1979.

DISTRIBUTION OF 1978 REVENUES
(includes gain on sale of fixed assets)



Because labour disputes at de Havilland Aircraft of Canada Ltd. delayed delivery of the first Dash 7, the Northern Division missed the busy spring period when Arctic airlift demand peaks. However, since delivery, performance of the Dash 7 has been favourable, due to its high reliability and efficient operating characteristics.

Wardair Equipment Ltd.

Wardair Equipment Ltd., a subsidiary of Wardair International Ltd., was formed in 1978 to accommodate the financing of the expansion of the international fleet. The company issued income debentures totalling $185,500,000 (U.S.) and $7,450,000 (Canadian) to a consortium of Canadian banks to purchase two Boeing 747-200s and two McDonnell Douglas DC-10-20 aircraft, including spares and related equipment. These aircraft are in turn leased to the airline, Wardair Canada (1975) Ltd.

Wardair Northern Equipment Ltd.

Another new subsidiary, Wardair Northern Equipment Ltd., was formed in 1978 to accommodate financing of the two Dash 7 aircraft plus spares and related equipment. Wardair Canada (1975) Ltd. issued preferred shares in the amount of $10,000,000 (Cdn.) to a consortium of Canadian banks. These funds were loaned to Wardair Northern Equipment Ltd., which will purchase the aircraft for leasing to Wardair Canada (1975) Ltd.

International Vacations Ltd.

The delayed delivery of new flight equipment combined with the delay in regulatory changes, had a serious impact on the operations of Intervac, Wardair's marketing subsidiary. Because of the substantial reduction in the planned number of available seats, downward adjustments of staff levels and advertising and promotional activity were implemented. Fixed costs such as staff training and the preparation of special promotional materials were absorbed.

Strong passenger preference for ABC flights as opposed to ITC packages were noted to all destinations where both ABC and ITCs were operated. It is clear the public prefers to select the length of stay and hotel accommodation to suit its needs. In 1978, over 75% of Intervac's passengers travelled on ABC flights. A substantial number also purchased their rental cars and holiday accommodation through Intervac's computer reservations system.

The North Atlantic

The results achieved on the North Atlantic routes during 1978 were most disappointing with Canadian load factors dropping to uneconomic levels. This was due to the fact that charter flights were not as flexible, as frequent, or in the case of family travel, as financially attractive as the Charter Class Fares offered in unprecedented quantity from Canada by scheduled carriers. Although the total number of travellers on North Atlantic air routes increased, the charter carriers' share dropped below the previous year while scheduled carriers enjoyed a growth rate well above average.

However, European and United Kingdom-originating traffic to Canada exceeded expectations in 1978. This is a growing market and one that the Company fully intends to develop in the future.

Weekly ABC flights between Toronto and London were re-introduced for the 1978-79 winter season in keeping with our policy of providing year-round service to major destinations.

The United States

ABC flights launched from Toronto and Winnipeg to Honolulu in 1978 enjoyed a high degree of acceptance in their respective markets. A series of winter ABC flights between Winnipeg and Tampa proved that the Manitoba market was

ready for the pre-booking concept to that destination. The Toronto to Florida ABC service was expanded with the addition of Orlando and Ft. Lauderdale as new Wardair destinations. Except for a brief period during January, load factors on all Florida flights were maintained at a satisfactory level.

Our California winter ABC program was continued on a year-round basis with weekly service to Los Angeles from Toronto. The scheduled carriers on this route responded by offering a limited number of seats on their daily flights at our fare levels. Our one flight per week could not stand up to their frequency of operation. Therefore, Intervac elected to withdraw from this market until it can compete on an equitable basis.

The Western Canada to Honolulu market enjoyed healthy growth during the year with the pre-booking flight predominating over the all-inclusive tour concept.

The Caribbean Area

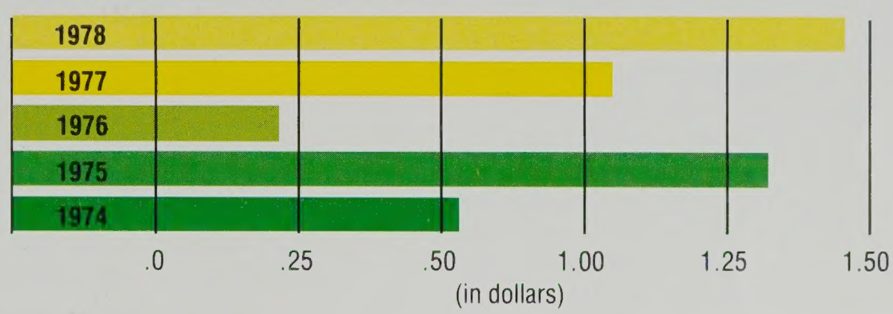
Holidays by Wardair vacation packages to Barbados were offered in Western Canada for the first time during the 1978-79 winter season. Advance sales indicate that the Vancouver, Calgary and Edmonton markets were ready for new destinations such as the Caribbean and it was clear by year end that this program would be successful.

Similar packages to Cartagena, Colombia were introduced on B-707 equipment during the 1977-78 fall and winter season. With first season load factors over 90%, it was decided to attempt a DC-10 operation during the 1978-79 season. Because the market did not sustain a wide-bodied jet operation, Intervac has decided to discontinue service to this destination.

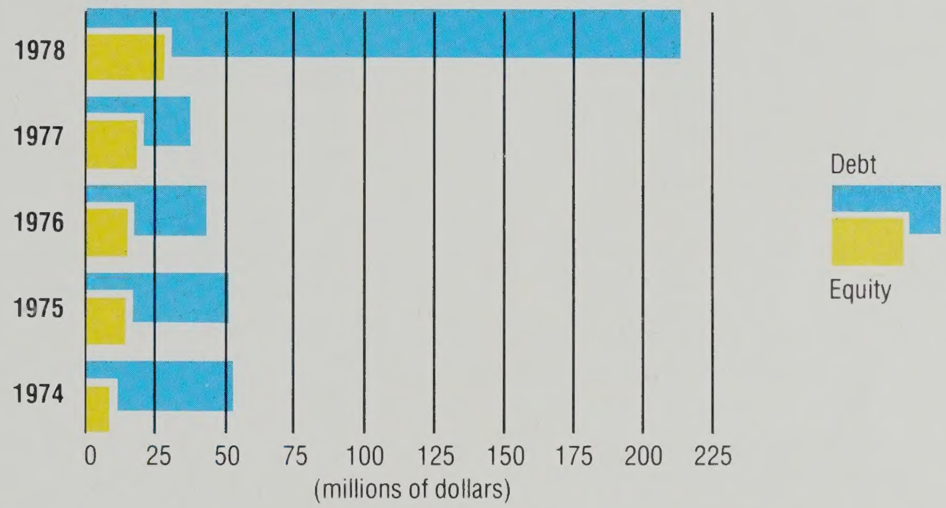
Jupiter Cruise Program

Our first year in cruising has proven there is a demand for this kind of vacation, and that it can be successfully marketed in Canada. However, it is also clear a lease

EARNINGS PER COMMON SHARE



CAPITAL INVESTED



arrangement like the one between Intervac and Epirotiki, owners of the Jupiter, does not offer sufficient potential for profit to make the level of risk acceptable. Accordingly, Intervac will terminate its arrangement with Epirotiki at the end of the 1978-79 season. However, Intervac is currently reviewing several alternate arrangements so it can continue to offer quality cruise holidays in association with Wardair flights.

Employee Relations

Effective April 1, 1978, Wardair Canada (1975) Ltd. reached agreement with the Canadian Airline Flight Attendants Association (CALFAA) covering wages and conditions of employment for a one-year period. Negotiations for a new agreement have commenced.

The collective agreement between Wardair Canada (1975) Ltd. and the International Association of Machinists and Aerospace Workers (IAM) covering certain maintenance employees in the international operation, has been in effect since June 30, 1977 and continues until June 30, 1979.

The Air Crew Association of Canada (ACAC) contract on behalf of flight officers and flight engineers on Wardair's international operation was renewed on July 1, 1978 for a two-year period.

In 1978, Wardair Canada (1975) Ltd. entered into initial collective agreements with two newly-certified employee bargaining agents. On June 19, 1978 IAM was certified by the Canada Labour Relations Board as the bargaining agent for certain Northern Division maintenance employees based in Yellowknife. On October 19, 1978 the Company entered into an agreement covering wages and conditions of employment for a two-year period.

On July 20, 1978 the Canada Labour Relations board certified the Canadian Association of Passenger Agents (CAPA) as the bargaining agent for certain Passenger Service Department employees of Wardair Canada (1975) Ltd. The Company entered into its first collective agreement with CAPA for a two-year period on September 1, 1978.

During 1978, representatives of Intervac's employee group met with management on four occasions to discuss working conditions and wages. Several changes have already been made as a result of these meetings and the Company is encouraged by the initiative displayed by this employee group.

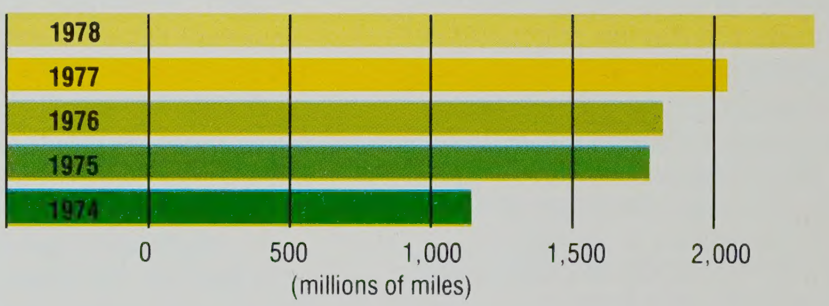
In addition, wage levels and conditions of employment for employees not represented by a bargaining unit or employee association were adjusted to the extent permissible under Anti Inflation Board regulations.

Outlook for 1979

It is clear that utilization of our expanded fleet during the first quarter of 1979 will meet or exceed forecasts. The extent of our marketing success for the remainder of the year will be largely dependent upon the timeliness and degree of change to Air Carrier Regulations.

We are confident our policy of concentrating marketing efforts on routes best suited to our all wide-bodied fleet will prove to be the most productive approach to a profitable future.

REVENUE PASSENGER MILES



Auditors' Report

To the Shareholders
Wardair International Ltd.

We have examined the consolidated balance sheet of Wardair International Ltd. as at December 31, 1978 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, except for the effect of not providing for deferred income taxes as explained in Note 9 to the financial statements, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Edmonton, Alberta
February 28, 1979

Thorne Riddell & Co.

Chartered Accountants

Consolidated Balance Sheet

(as at December 31, 1978) (In thousands of dollars)	1978	1977
ASSETS		
CURRENT ASSETS		
Cash and short term investments (note 2)	**$ 36,973**	$ 17,750
Accounts receivable	**4,566**	2,441
Inventories	**6,070**	3,471
Deposits and prepaid expenses	**7,000**	2,503
	54,609	26,165
PROPERTY AND EQUIPMENT, at cost		
Flight equipment	**243,040**	73,470
Land, buildings and ground equipment	**16,745**	8,663
	259,785	82,133
Less accumulated depreciation	**26,829**	24,365
	232,956	57,768
DEFERRED CHARGES (note 3)	**2,426**	1,571
	$289,991	$ 85,504
LIABILITIES & SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**$ 22,545**	$ 11,675
Dividends payable	**252**	288
Charter prepayments	**26,154**	16,639
Long term debt – current maturities	**17,217**	6,200
	66,168	34,802
LONG TERM DEBT (note 4)	**196,184**	32,051
PREFERENCE SHARES OF SUBSIDIARY COMPANY (note 5)	**4,711**	—
SHAREHOLDERS' EQUITY		
Capital Stock		
Authorized – 300,000 12% cumulative redeemable non-voting convertible preferred shares of $10 each, par value; 5,000,000 common shares without par value		
Issued – 210,000 12% preferred shares (note 6)	**2,100**	2,400
3,287,570 common shares	**1,059**	1,059
Purchase fund for redemption of preferred shares (note 6)	**300**	300
Retained earnings (notes 4, 6 and 9)	**19,469**	14,892
	22,928	18,651
	$289,991	$ 85,504

Approved by the Board

Maxwell W. Ward, Director

T. L. Spalding, Director

Consolidated Statement of Earnings

(Year ended December 31, 1978) (In thousands of dollars)	1978	1977
REVENUES	**$143,059**	$110,665
EXPENSES		
Operating	**109,175**	82,073
Marketing and administration	**19,159**	15,014
Depreciation	**8,841**	5,400
Amortization of deferred charges	**452**	420
	137,627	102,907
Earnings from operations	**5,432**	7,758
Interest on long term debt (note 1)	**11,456**	3,924
	(6,024)	3,834
Gain on sale of aircraft and related equipment	**11,433**	—
NET EARNINGS (note 9)	**5,409**	3,834
EARNINGS PER COMMON SHARE (in dollars) (note 9)		
Calculated after providing for annual dividends on preferred shares	**$1.45**	$1.08

Fully diluted earnings per common share, assuming conversion of all preferred shares is calculated at $1.26 in 1978 and $0.94 in 1977.

Consolidated Statement of Retained Earnings

(Year ended December 31, 1978) (In thousands of dollars)	1978	1977
BALANCE AT BEGINNING OF YEAR	**$14,892**	$11,543
NET EARNINGS	**5,409**	3,834
	20,301	15,377
DIVIDENDS		
Preference shares of subsidiary company	**383**	—
12% Preferred shares	**252**	288
Common shares	**197**	197
	832	485
BALANCE AT END OF YEAR	**$19,469**	$14,892

Consolidated Statement of Changes in Financial Position

(Year ended December 31, 1978) (In thousands of dollars)	1978	1977
SOURCE OF FUNDS		
Net earnings	$ 5,409	$ 3,834
Add charges not requiring cash expenditure		
Depreciation	8,841	5,400
Amortization of deferred charges	452	420
Gain on sale of aircraft and related equipment	(11,433)	—
	3,269	9,654
Issue of preference shares of subsidiary company	4,711	—
Proceeds from sale of fixed assets	18,344	462
Proceeds from long term debt	182,657	—
	208,981	10,116
APPLICATION OF FUNDS		
Additions to fixed assets	190,940	5,320
Reduction of long term debt	18,524	6,327
Deferred charges incurred, net of recoveries	1,307	689
Dividends	832	485
Redemption of 12% preferred shares	300	300
	211,903	13,121
DECREASE IN WORKING CAPITAL	2,922	3,005
DEFICIENCY IN WORKING CAPITAL AT BEGINNING OF YEAR	8,637	5,632
DEFICIENCY IN WORKING CAPITAL AT END OF YEAR	$ 11,559	$ 8,637

Notes to Consolidated Financial Statements (Year ended December 31, 1978)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: Wardair Canada (1975) Ltd. and its wholly-owned subsidiary, Redrock Reinsurance Limited; Wardair Equipment Ltd.; Wardair Northern Equipment Ltd.; International Vacations Ltd.; Wardair (U.K.) Limited; Wardair Jamaica Limited and Wardair Hawaii Limited.

Translation of Foreign Currencies

Amounts in foreign currencies are translated to Canadian dollars on the following basis:

(i) current assets and current liabilities at exchange rates in effect at the balance sheet date except current maturities of long-term debt;

(ii) fixed assets at exchange rates in effect at the dates of acquisition;

(iii) long term debt at exchange rates in effect at the dates incurred;

(iv) revenues and expenses at the average annual rate of exchange.

Gains and losses resulting from foreign exchange transactions are reflected in earnings for the year.

Inventories

Inventories are valued at the lower of cost and replacement cost.

Property and Equipment

Depreciation is computed by the straight line method:

(i) jet aircraft and related equipment – over fourteen years to 15% residual value;

(ii) turbo aircraft and related equipment – over twelve years to 15% residual value;

(iii) other equipment and property – at various rates over the estimated useful life of the asset.

Engine and airframe overhaul costs are charged to earnings in the year incurred. Significant expenditures for modifications are capitalized. Upon retirement or disposal of equipment, the related cost and accumulated depreciation are removed from the accounts and the gain or loss, if any, is reflected in earnings.

Deferred Charges

Deferred charges are amortized on the staight line method:

(i) financing costs over the term of the debt;

(ii) training expenses over ten years;

(iii) inclusive tour development over four years to 1980.

Interest on long term debt

Interest on long term debt includes interest on secured income debentures in the amount of $7,673,752 which is not deductible for income tax purposes.

2. CASH AND SHORT TERM INVESTMENTS

Short term investments include $24,372,827 set aside as segregated securities, to meet charter prepayment obligations as provided for under the Trust Indenture referred to in note 4 (a), and in part as security for a bond required by certain regulatory authorities.

3. DEFERRED CHARGES

	1978	1977
Financing costs	**$1,875,022**	$ —
Training expenses	**375,823**	1,221,738
Inclusive tour development	**174,707**	262,061
Other	—	86,574
	$2,425,552	$1,570,373

4. LONG TERM DEBT

(a) On June 9, 1978, the Company issued, under the terms of a Trust Indenture between the Company and National Trust Company, Limited as trustee, Series A, B, C and D Secured Income Debentures, due November 30, 1987. Series A, B and C are repayable in U.S. funds and Series D in Canadian funds. The debentures may be converted into secured debentures at the option of the Company or the holders, upon the occurrence of certain prescribed events. The Company is required to redeem specified amounts of the debentures on May 31 and November 30 in each year commencing November 30, 1979. Interest is payable at 52% of the lending institution's base interest rate plus 1.50% for U.S. funds and 52% of the bank prime rate plus 1.50% for Canadian funds. The Company's obligations under the income debentures and Trust Indenture are secured by a specific mortgage upon certain property and by a floating charge upon all other property and assets of the companies, and have been further secured by limited guarantees of manufacturers and government agencies.

	1978	1977
(i) Series A Secured by two McDonnell Douglas DC-10 series 30 aircraft, installed General Electric Model CF6-50 series engines and auxiliary equipment	**$ 99,124,263**	$ —
(ii) Series B Secured by two Boeing Model B747 series 211B aircraft (one to be acquired in April, 1979, see Note 8), installed General Electric Model CF6-50 series engines and auxiliary equipment	**108,727,114**	—
(iii) Series C Secured by six General Electric Model CF6-50 series engines and auxiliary equipment	**7,536,702**	—

	1978	1977
(iv) Series D		
To be secured by ground support, tooling and commissary equipment, one Univac Model 1100/80 computer and auxiliary equipment, and three steel buildings as acquired	**$ 7,450,000**	$ —
	222,838,079	—
Less undrawn amounts held by Trustee	**40,180,686**	—
	182,657,393	—
(b) 10.00% Conditional Purchase Agreements, due April, 1983; $10,664,000 is payable in U.S. funds. Secured by one Boeing 747 and auxiliary equipment	**15,851,876**	18,436,141
(c) Secured Note Purchase Agreement, due November, 1983, with interest at 2.25% above prime lending rate. Secured by one Boeing 747 and auxiliary equipment	**5,300,822**	7,686,194
(d) 8% Term loan, due November, 1982, payable in U.S. funds to Export-Import Bank of the United States. This loan is guaranteed by a commercial bank for a fee of 2.25% of a portion of the loan and 1.5% of the remainder.	**7,492,622**	7,492,622
(e) Bank term loans, at rates varying between bank prime rate plus 1.5% and 2%, final instalment due November, 1983. Secured by a chattel mortgage on specific aircraft and engines, general assignment of accounts receivable and a land mortgage on the Yellowknife hangar	**2,066,246**	2,952,746
(f) 6.50% Debenture – Series A, called for redemption at $102.60 on October 2, 1978	—	1,574,000
(g) 10.00% Debenture, due February, 1979. Secured by a first fixed charge on DHC-6 aircraft	**12,854**	89,978
(h) Miscellaneous mortgages	**18,981**	18,790
	213,400,794	38,250,471
Less principal due within one year	**17,216,931**	6,199,647
	$196,183,863	$32,050,824

The debt agreements contain certain restrictions as to the creation of additional debt, the creation of additional liens and guarantees, the payment of cash dividends and the amounts of loans to officers and employees. In addition, certain debt agreements include covenants by the Company with respect to maintenance of working capital, debt-equity ratios, capital expenditures, investments, sale of assets and issue of shares.

Principal due on existing long term debt in each of the years 1980 to 1983 is $28,430,733, $28,742,063, $28,868,821 and $26,550,265 respectively, expressed in Canadian funds at historical rates.

Long term debt outstanding and repayable in U.S. dollars translated at current rates at December 31, 1978 would be $201,175,049 which is $7,810,144 more than the amount at which it is recorded in the financial statements.

5. PREFERENCE SHARES OF SUBSIDIARY COMPANY

By special resolution Wardair Canada (1975) Ltd. increased its share capital by the creation and issuance of redeemable preference shares as follows:

470 Class A	$4,700,000
465 Class B	4,650,000
65 Class C	650,000
Total proceeds	10,000,000
Proceeds not utilized	5,289,393
Proceeds expended	$4,710,607

These shares are non-voting, have a par value of $10,000 each, are entitled to cumulative dividends at variable rates equal to 52% of the average bank prime rate for the dividend period plus 1.5% payable quarterly commencing September 30, 1978 and are redeemable in semi-annual payments of $588,235 commencing December 31, 1979 or at any other date in any amounts, at the Company's option.

The proceeds from these shares are to be used for the purchase of two de Havilland DHC-7 aircraft and related equipment and any funds not utilized at December 14, 1979 must be repaid to the shareholders. Under the terms of the agreement between the preference shareholders and The de Havilland Aircraft of Canada, Limited, the latter may be obligated under certain prescribed conditions, to acquire the preference shares. In such event, de Havilland's position would be secured by a debenture granting a first fixed charge on the de Havilland DHC-7 aircraft and auxiliary equipment and any funds not then utilized.

6. 12% PREFERRED SHARES

Each preferred share is convertible, at the option of the holder, into 3 1/3 fully paid common shares and is redeemable at par value or under certain prescribed conditions at $11 per share.

In accordance with these provisions, the Company redeemed 30,000 preferred shares during the year under review and another 30,000 preferred shares subsequent to the year end.

Annually, prior to December 31, the Company is required to appropriate $300,000 of its retained earnings as a Purchase Fund for Redemption of Preferred Shares, which appropriation is returned to retained earnings subsequent to the redemption of a related number of preferred shares. At December 31, 1978, the Purchase Fund totalled $300,000.

In addition, on the redemption of each 30,000 preferred shares the Company is required to designate $300,000 of its retained earnings as a Capital Redemption Reserve Fund as defined in the Alberta Companies Act. At December 31, 1978, a total of $900,000 of retained earnings is so designated and is not available for dividends.

7. PENSION PLAN

Effective January 1, 1977 and January 1, 1978, certain improvements were made to the Company's pension plan by an adjustment of earnings level to improve benefits which, based on an acturial report, resulted in an unfunded liability of approximately $750,000. This unfunded liability is being amortized by annual payments of $75,000 to 1992.

8. COMMITMENTS

Leases

The Company is obligated under long term lease agreements for aggregate basic annual rentals of approximately $2,696,000, $2,605,000, $2,298,000, $2,079,000 and $1,859,000 in each of the years 1979 to 1983 respectively.

Fleet expansion

The Company has entered into a contract with Boeing Company for the purchase of one B747-200B aircraft at a total cost of approximately $45,000,000 (U.S.) to be delivered in April, 1979. Included in fixed assets is an amount of $18,000,000 being a deposit on this aircraft.

The Company contracted with de Havilland Aircraft of Canada Ltd. for the purchase of two de Havilland DHC-7 aircraft, the second to be delivered in May, 1979 at a cost of $4,400,000 including parts.

Cruise Ship rentals

The Company has entered into agreements for the rental of a cruise ship and is committed to rental payments in 1979 of $1,571,000 (U.S.).

Condominium purchase

The Company has advanced $55,000 (U.S.) as a deposit with an offer to purchase 110 condominium units in Hawaii subject to satisfactory negotiation of financing and terms of participation. The total purchase price is estimated to be $6,300,000 (U.S.).

9. INCOME TAXES

The Company and its subsidiaries claim capital cost allowances and other deductions allowed for income tax purposes in excess of the related amounts reflected in the accounts and provide in their accounts only for the taxes payable for the year. This accounting treatment differs from the tax allocation basis which requires that the income tax provision be based on earnings reported in the accounts.

If the tax allocation basis had been followed in current and prior years, earnings would have been reduced by $5,654,000 for 1978 and $1,815,000 for 1977. Reported net earnings (loss) per common share would have been ($0.27) for 1978 and $0.53 for 1977. The cumulative effect on retained earnings to December 31, 1978 would have been a reduction of $13,401,000.

The Canadian Institute of Chartered Accountants recommends the tax allocation basis for all but certain regulated corporations. Management does not concur that this principle is appropriate for the Company. The capital cost allowance on flight equipment is substantially in excess of the depreciation recorded in the accounts. Consequently, the deferred tax liability which results from the tax allocation basis is expected to be indefinitely postponed. Accordingly, there should be no necessity to provide an amount for which the payment date is indeterminable.

10. REMUNERATION OF DIRECTORS AND OFFICERS

Remuneration of the directors and officers of the Company and its subsidiaries, including the five highest paid employees other than flight personnel, amounted to $569,000.

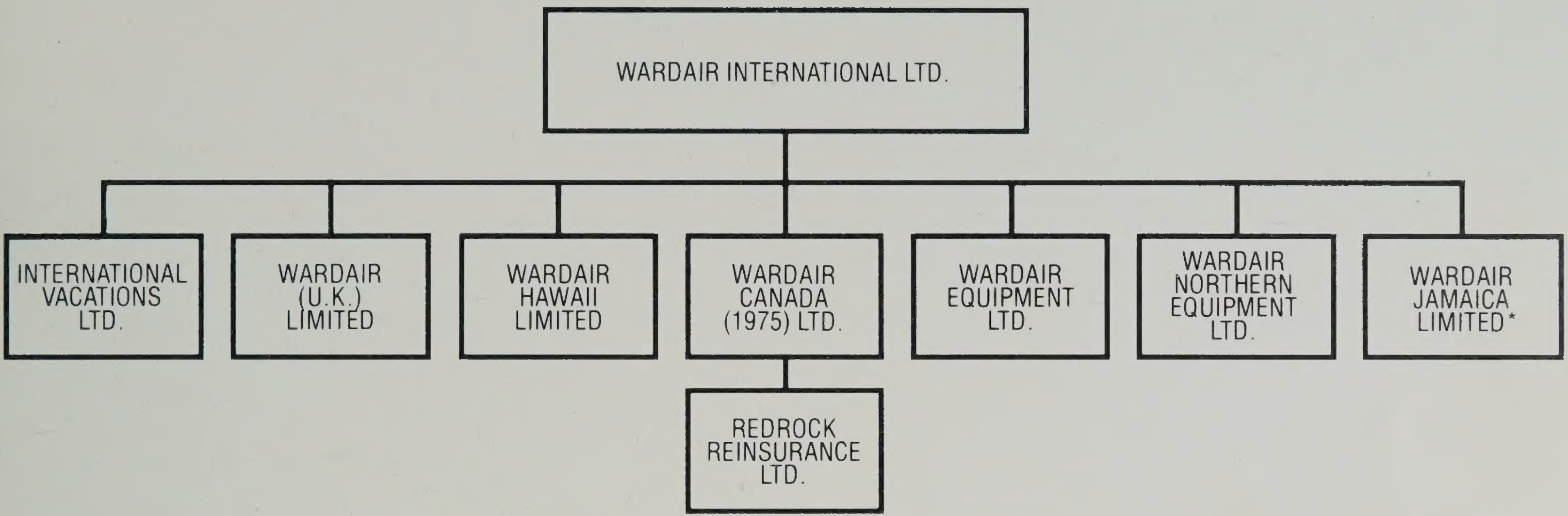
Five Year Summary

FINANCIAL (dollar amounts in thousands)	1978	1977	1976	1975	1974*
Revenues	$143,059	$110,665	$89,685	$70,923	$41,207
Operating costs	137,627	102,907	83,889	61,130	36,899
Earnings from operations	5,432	7,758	5,796	9,793	4,308
Interest on long term debt	11,456	3,924	4,759	5,133	2,638
(Gain) on sale of aircraft and related equipment	(11,433)	—	—	—	—
Net earnings	5,409	3,834	1,037	4,660	1,670
DIVIDENDS					
Preference shares of subsidiary company	383	—	—	—	—
12% preferred	252	288	324	379	—
Common	197	197	197	—	—
	832	485	521	379	—
Earnings retained in year	$ 4,577	$ 3,349	$ 516	$ 4,281	$ 1,670
Long term debt	$213,401	$ 38,251	$44,434	$50,616	$52,169
Preferred shares of subsidiary company	4,711	—	—	—	—
Shareholders' equity	22,928	18,651	15,602	15,342	9,071
Invested capital	$241,040	$56,902	$60,036	$65,958	$61,240
Depreciation and amortization	$ 9,293	$ 5,820	$ 5,279	$ 4,998	$ 4,941
Cash flow provided by operations	$ 3,269	$ 9,654	$ 6,316	$ 9,658	$ 6,611
Additions to fixed assets	$190,940	$ 5,320	$ 3,662	$ 6,375	$24,980
Reduction in long term debt	$ 18,524	$ 6,327	$ 6,129	$12,695	$ 2,258
Operating margin	3.8%	7.0%	6.5%	13.8%	10.5%
Return on average capital employed	9.5%	12.8%	9.0%	15.1%	11.2%
Debt-equity ratio	7.7	2.1	2.8	3.3	5.8
Price-earnings ratio	3.2	3.0	10.4	1.6	2.7
PER COMMON SHARE DATA (in dollars)					
Earnings	$1.45	$1.08	$ .22	$1.33	$ .52
Dividends	.06	.06	.06	—	—
Book Value	6.34	4.94	3.92	3.72	1.87
OPERATING (international service)					
Passengers carried	764,307	637,674	547,149	527,070	350,457
Revenue passenger miles (000's)	2,359,672	2,022,889	1,798,700	1,762,459	1,176,512
Aircraft miles (000's)	9,602	8,265	7,991	7,610	5,690
Aircraft hours	19,860	16,959	16,165	15,488	11,525
PERSONNEL					
Average number of employees	1,652	1,410	1,384	1,263	948
Employee wage and benefits (000's)	$25,307	$20,630	$17,810	$12,981	$ 8,072

*Does not reflect prior years' adjustment for depreciation and change in overhaul provision policy made in 1976.

Distribution of Common Shares

	SHAREHOLDERS 1978	SHAREHOLDERS 1977	SHARES HELD 1978	SHARES HELD 1977	PERCENTAGE 1978	PERCENTAGE 1977
CANADA	1,587	1,448	3,269,645	3,272,191	99.45	99.53
UNITED STATES	27	21	17,215	14,569	.53	.44
OTHER	6	7	710	810	.02	.03
TOTAL	1,620	1,476	3,287,570	3,287,570	100.00	100.00



Wholly-owned Subsidiaries, Officers and Senior Management

International Vacations Ltd.

Maxwell W. Ward
President

T. L. Spalding
Executive Vice-President

M. D. Ward
Secretary-Treasurer

G. D. Curley
Vice-President and General Manager

N. A. Patterson
Vice-President, Finance

B. Walker
Director, Marketing Operations

J. A. Craig
Controller

Wardair (U.K.) Limited

Maxwell W. Ward
President

J. L. Standley
Managing Director

G. W. Hopkinson
Secretary

Wardair Hawaii Limited

Maxwell W. Ward
President

T. L. Spalding
Executive Vice-President

M. D. Ward
Secretary-Treasurer

Wardair Canada (1975) Ltd.

Maxwell W. Ward
President

T. L. Spalding
Executive Vice-President

M. D. Ward
Secretary-Treasurer

G. D. Curley
Vice-President, Marketing

N. A. Patterson
Vice-President, Finance

A. B. Freeman
Vice-President, Flight Operations

C. D. McNiven
Vice-President, Maintenance and Engineering

G. N. R. Bell
Staff Vice-President

J. V. Gordon
Director, Passenger Services

R. W. Flannelly
Director, Crew Scheduling

A. W. Jackman
Director, Cabin Services

M. J. Kozak
Director, Catering Services

M. K. Borrowman
Controller

J. I. Buck
Manager, Northern Operations

Redrock Reinsurance Limited†

D. F. Babensee
Director

G. C. Colclough
Director

T. L. Spalding
Director

Sir A. D. Spurling
Director

Wardair Equipment Ltd.

Maxwell W. Ward
President

T. L. Spalding
Executive Vice-President

M. D. Ward
Secretary-Treasurer

G. D. Curley
Vice-President

N. A. Patterson
Vice-President, Finance

Wardair Northern Equipment Ltd.

Maxwell W. Ward
President

T. L. Spalding
Executive Vice-President

N. A. Patterson
Secretary-Treasurer

*Inactive at present

†Wholly-owned subsidiary of Wardair Canada (1975) Ltd.